Testimony of Daniel Klett

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Good morning, Madam Chairman and members of the Commission. My name is Daniel Klett. I'm an economist with Capital Trade testifying on behalf of the U.S. urea industry in this sunset review. I will be addressing three issues. First, prilled vs. granular urea and changes since the prior sunset review. Second, an analysis of prices on a net-back basis and implications for the attractiveness of the U.S. market for urea exporters in Russia and Ukraine. Third, information relevant to the likelihood of underselling.

Mr. Mulhall discussed prilled and granular urea competition. I want to discuss a few additional points on this issue. First, there is now significant existing and planned granular urea capacity in Russia, and an exisiting granular urea plant in Ukraine. IFDC's latest urea capacity listing by plant shows granular operating urea capacity in Russia in the 2007/08 fertilizer year of 1.8 million short tons, increasing to 2.3 million short tons in the 2010/2011 fertilizer year. Additional granular urea capacity under construction stands at 1.2 million short tons projected for the 2012/13 fertilizer year, for a total of 3.5 million short tons of granular urea capacity by that year. The Americas is a significant export region for Russia and Ukraine. There is no doubt that absent the order a portion of the granular urea capacity in Russia and Ukraine will be directed to the United States. In Exhibit 22 to our Prehearing Brief you will a EuroChem press release indicating that the United States is one of the two primary markets for Russian granulated urea.

Second, although some U.S. prilled urea goes to specialized industrial applications, this constitutes a small share of prilled urea consumption in the United States. Most U.S. prilled urea consumption is still for direct fertilizer application and for standard industrial applications where contract pricing is tied to published Green Markets prices for fertilizer grade urea at New Orleans.

Third, if there is any question regarding the ability of prilled urea to be substituted for granular urea in applications, consider that, as noted in your Staff Report, many purchasers reported "availability" of prilled urea to be a major factor limiting the potential for prilled urea being substituted for granular urea. It follows that increased availability of prilled urea imports from Russia and Ukraine with the revocation of the order will result in greater potential to substitute prilled urea for granular urea, and consequently adverse volume and price effects for U.S. producers' granular urea sales as well as sales of prilled urea.

Moreover, it is clear that the U.S. market is very attractive for Russian and Ukrainian exporters. We have prepared a net-back analysis that is in our Prehearing Brief at Exhibit 19. **Slide 1** summarizes the methodology. The starting point for the analysis are average unit values for Russian and Ukrainian urea exports derived from GTIS data presented in the Staff Report. I also have access to this same database, and analyzed the data on a monthly basis during 2005 through June 2011, for exports to all markets and for Brazil. I analyzed Brazil separately because it is in the Americas, shipments are by ocean-going vessel, and ocean freight rates from Black Sea or Baltic ports to Brazil are similar to ocean freight from these same ports to the U.S. Gulf. In addition, Brazil is the single largest export market for both Russia and Ukraine.

The analysis compares average f.o.b. export prices from Russia and Ukraine to all markets and to Brazil separately with a calculated net-back price for exports to the United States, based on prevailing U.S. prices at New Orleans from Green Markets for prilled and granular urea, less ocean freight from Russia and Ukraine to the United States. The ocean freight used in the analysis is Black Sea to Brazil from Fertecon. This ocean freight is very similar to Baltic to

East Coast Mexico ocean freight rates, and to the ocean freight rates for actual imports of urea from Russia from Census data for the few months where we have comparisons.

Slide 2 summarizes the results. The U.S. provided a more favorable net back price based on prilled urea prices in NOLA compared to the average unit value for total exports from Russia. The U.S. market provided a more favorable net-back price in 72 of 77 months. The higher U.S. net-back increased from $54/ST on average in 2008 to $81/ST in the first six months of 2011. Comparing NOLA prilled urea prices to Russia's average export price to Brazil, the more favorable net-back price for exporting to the United States increased from $54/ST in 2008 to $87/ST in the first six months of 2011. The United States consistently provided more favorable net-back prices than alternative export markets for Russia, with the exception of a limited number of months in late 2008 when the trade press reported that non-U.S. markets provided more favorable pricing, and some imports into the U.S. Gulf were in fact diverted to non-U.S. destinations. This occurrence in 2008 demonstrates just how sensitive trade flows are to differences in regional pricing.

For Ukraine, the U.S. market provided a more favorable price net-back in 70 of 77 months based on prilled urea prices at NOLA compared to the average unit value for total exports, at $44/ST on average in 2008 and $75/ST in the first six months of 2011. Comparing NOLA prilled prices to Ukraine's average export price to Brazil, the more favorable net-back price for exporting to the United States increased from $39/ST in 2008 to $79/ST in the first six months of 2011.

Regarding underselling, there is no importer questionnaire from Eurochem, and the Commission has no sales price information into the U.S. market for the 165 thousand short tons of urea imported from Russia in 2010 and the first half of 2011. However, three of four purchasers did report that urea imports from Russia and Ukraine were lower-priced than U.S.-produced urea. In the 2nd sunset review the Commission compared Black Sea and Middle East prices at their ports of exportation, and average unit values of imports into non-U.S. markets, as indicators of likelihood of underselling. We have provided similar comparisons on this basis for the current period of review.

Black Sea FOB prices export prices have been lower than Middle East FOB prices in 76 of the 80 months from 2005 through August 2011. During 2010 and through August 2011 these Black Sea prices at the port averaged $15 / short ton lower than Middle East prices. Russian urea also may be exported from Baltic ports, and Baltic FOB prices averaged $21 / short ton lower than FOB Middle East prices over this same period. These comparisons are relevant for likely underselling for two reasons. First, the Middle East is a major non-subject supplier of urea to the United States. Second, ocean freight from the Middle East to the U.S. Gulf is comparable to Black Sea or Baltic ports to the U.S. Gulf.

We can also compare average import unit landed values for Russian and Ukrainian and other urea imports into the EU-15 countries, Brazil, Peru, and Canada. The EU-15 comparisons are of particular interest because Russia, Ukraine, and the Middle East are major suppliers to these countries, and import value data are available on a c.i.f. basis. The average unit value of imports from Russia and Ukraine combined was lower than for imports from Middle East countries in 75 of 77 months examined since 2005, and averaged $29 per short ton less in 2010 and $22 per short ton less in the first five months of 2011.

Imports into Peru are also on a c.i.f. basis, and Russian and Ukraine accounted for 70 percent of imports into Peru, followed by imports from other Eastern European and FSU countries. Comparisons were available in only eight of the 17 months during 2010 through May

2011. However, in seven of those eight months the average unit value of imports from Russia and Ukraine was lower than for imports from Eastern European and FSU countries.

Import values for Brazil and Canada are available on only an f.o.b. basis so are not as useful as proxies for likely underselling. Nonetheless, Brazil is a major export market for both Russian and Ukraine, and one of the few markets into the Americas where Middle Eastern countries also have a significant presence. Imports from Russia and Ukraine were lower priced than imports from Middle Eastern countries in 21 of the 26 months for which comparisons were available, with the price differential being $13 per short ton or greater.

There are even fewer comparisons on a monthly basis for Canada, but Russia and Ukraine accounted for 16.5 percent of total urea imports into Canada in the first seven months of 2011. There are four months in 2010 and 2011 where there were commercially significant import volumes from Middle East countries and Russia/Ukraine, and underselling by Russia/Ukraine in all four comparisons.

Thank you, and I will be happy to answer any questions you may have.